

EMPLOYEE PLANS FY 2007 WORK PLAN

Operating Priorities



September 2006

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FY 2007 Employee Plans Work Plan

Executive Summary

EP Operating Priorities support the IRS's Strategic Plan for FY2007-09. The Strategic Plan outlines three strategic goals that guide the future direction of the agency:

- ✓ Improve Taxpayer Service;
- ✓ Enhance Enforcement of the Tax Law; and,
- ✓ Modernize the IRS through its People, Processes and Technology.

In support of these goals, EP has committed to the following Operating Priorities:

- **Detect and Deter Abusive Tax Schemes through Accelerated Enforcement Actions and Educational Strategies Focusing On Non-Global Settlement Initiative (GSI) Participants, & the Identification of New Abusive Schemes -**
EP will continue to take an aggressive stance towards all identified abusive tax avoidance transactions. Examinations are continuing and resolution strategies have been developed for S Corporation ESOPs that violate IRC 409(p), and IRC 412(i) plans that take deductions for excessive insurance. The EP Compliance Unit (EPCU) will be utilized to supplement examinations of those ESOPs and 412(i) plans that could be abusive. We will conduct examinations or other compliance activities involving those taxpayers that received Announcement 2005-80 GSI letters, but did not elect to participate in the GSI. Potential abusive issues will continue to be evaluated and developed for enforcement action.
- **Coordinate Information and Processes with DOL and PBGC to Monitor Pension Funding** – Interagency coordination on pension funding issues has escalated in the wake of several prominent bankruptcies which have resulted in failures to fund seriously under funded pension plans. We will continue to partner with the PBGC and DOL to discuss information sharing and ideas to improve inter-agency coordination. Action will also be taken to develop and issue technical guidance related to pension legislation that affects plan funding rules.
- **Take Timely Action to Implement the Provisions of the Pension Protection Act of 2006, Including the Issuance of Technical Guidance and the Processing of Cash Balance Plans that have been Suspended –**
Approximately 1,250 determination applications for cash balance conversion plans had been held in suspense for an extended period due to pending legislative proposals and various court decisions. The passage of the Pension Protection Act of 2006 on August 17th provides statutory guidance that will allow for the processing of these applications. Timely actions will be taken to expeditiously and consistently process these applications during FY2007. Rulings & Agreements will work jointly with Chief Counsel and Treasury to issue timely technical guidance.

- **Analyze and Improve the Focused Examination Concept for All Examinations, and Reinforce the Focus on Key Examination Activities and Issues** – This initiative is designed to allow agents to more effectively and efficiently perform an audit by focusing on key issues. Mandatory pre-determined issues will be identified for audits by plan type or other determined criteria based upon historical information and local knowledge, while still allowing the agent the flexibility of expanding the scope if necessary.
- **Embed Research and Analysis into Inventory Selection Utilizing Market Segments while Leveraging Data Analysis Unit (DAU) and EPCU Resources to Ensure Expanded and Broader Coverage through Compliance Contacts** - Targeted exams will be conducted in market segments where the baseline data indicated potential non-compliance. The results of these exams will be used to guide the future direction of examination resources. The DAU will also be expected to do expert level data analysis to determine appropriate examination strategies and ways to improve the use of existing resources.
- **Continue Efforts to Further Reduce the Inventory Backlog of Voluntary Compliance (VC) Submissions through Improved Work Processes and the Use of Resources throughout Rulings and Agreements** – As a result of case processing efficiencies and the support of Technical & Determinations resources, the inventory of VC submissions trended downward during FY2006 and is expected to continue during FY2007. Work processes will be further analyzed to determine where additional improvements can be made, and resources from Technical & Determinations will be applied at a somewhat reduced rate to further support the VC staff.
- **Provide Plain Language Guidance and Communicate Enforcement Trends and Tips to Plan Sponsors and Participants to Enhance Mistake/Abuse Prevention and Promote Retirement Savings via Qualified Plans**– CE&O will coordinate with Rulings & Agreements and Examinations on providing plain language guidance, coming from published guidance and other identified needs. Where possible, CE&O will link the plain language guidance to communicating related enforcement trends/tips.
- **Ensure that the New Staggered Determination Process Stays on Schedule, with Special Emphasis on the Review of Defined Contribution Pre-approved Plans** - The consolidation of the Master & Prototype and Volume Submitter programs will allow for greater control of the pre-approved process resulting in the timely disposition of the Defined Contribution pre-approved plans. Several strategies have been implemented by the program coordinators and management to ensure success. It is expected that 7,200 of the 10,400 pre-approved applications will be closed during FY07.

FY2007 EP Operating Priorities

Employee Plans shares the IRS's three strategic goals of:

- 1) Improving taxpayer service;
- 2) Enhancing enforcement of the tax law; and
- 3) Modernizing the IRS through its people, processes and technology.

To achieve these goals EP will focus on the following Operating Priorities:

- Detect and Deter Abusive Tax Schemes through Accelerated Enforcement Actions and Educational Strategies Focusing On Non-GSI Participants and the Identification of New Abusive Schemes
- Coordinate Information and Processes with DOL and PBGC to Monitor Pension Funding
- Take Timely Action to Implement the Provisions of the Pension Protection Act of 2006, Including the Issuance of Technical Guidance and the Processing of Cash Balance Plans that have been Suspended
- Analyze and Improve the Focused Examination Concept for All Examinations, and Reinforce the Focus on Key Examination Activities and Issues
- Embed Research and Analysis into Inventory Selection Utilizing Market Segments while Leveraging DAU and EPCU Resources to Ensure Expanded and Broader Coverage through Compliance Contacts
- Continue Efforts to Further Reduce the Inventory Backlog of Voluntary Compliance Submissions through Improved Work Processes and the Use of Resources throughout Rulings and Agreements
- Provide Plain Language Guidance and Communicate Enforcement Trends and Tips to Plan Sponsors and Participants to Enhance Mistake/Abuse Prevention and Promote Retirement Savings via Qualified Plans
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□ **Detect and Deter Abusive Tax Schemes through Accelerated Enforcement Actions and Educational Strategies Focusing on Non-Global Settlement Initiative (GSI) Participants and the Identification of New Abusive Schemes**

▪ **Background**

Abusive tax avoidance transactions (ATAT) involving employee plans continue to be a concern. Addressing the abuses in a timely and consistent manner is a very high priority. The two primary transactions that take advantage of the tax-exempt status of retirement plans are:

- S Corporation ESOPs that violate IRC 409(p), and
- IRC 412(i) plans that take deductions for excessive insurance.

EP management and agents have been actively pursuing these abuses in examinations and outreach. EP is also leading cross-divisional Issue Management Teams (IMTs) in an effort to address these abuses through the development of resolution strategies and program guidance. In addition, EP will perform an assessment to determine those areas most vulnerable to fraud and abuse within our customer base, and alert TE/GE customers of fraud and abuse.

To inform stakeholders about abuses involving retirement plans, both internal and external web sites have been developed that discuss the ATAT program.

The external web site, irs.gov, provides:

- Information on “listed transactions” in retirement plans, and
- Technical guidance that has been issued to shut down transactions that are deemed abusive.

▪ **FY 2007 Strategies**

EP will continue to take an aggressive stance towards all identified abusive tax avoidance transactions. Examinations are continuing and resolution strategies have been developed for S Corporation ESOPs that violate IRC 409(p), and IRC 412(i) plans that take deductions for excessive insurance. The EP Compliance Unit will be utilized to supplement examinations of those ESOPs and 412(i) plans in order to achieve a higher coverage rate for these types of plans.

Examinations or other compliance activities will be initiated involving those taxpayers that received Announcement 2005-80 GSI letters, but did not elect to participate in the GSI. EP will partner with SBSE and LMSB on ATAT examinations to ensure full compliance. Support will continue to be provided to the Lead Development Center (LDC) for investigations involving qualified retirement plans. Potential abusive issues will continue to be developed for enforcement action.

In furtherance of our continuing efforts to identify other abusive transactions and develop resolution strategies, we have partnered with SBSE and the Lead Development Center and worked with Criminal Investigation to address the abusive pension plan practices identified in the Gulf Coast Practitioner Project. This effort will continue into FY2007.

In addition, CE&O will be refining and updating the abusive transaction information on the Retirement Plans web page (www.irs.gov/ep) and the EP Intranet site.

□ **Coordinate Information and Processes with DOL and PBGC to Monitor Pension Funding**

▪ **Background**

Defined benefit pension plans are subject to minimum funding standards under the Code. During the 1990s, when the stock market was booming, the plans were well-funded and often no contribution was required by the minimum funding standards. With the stock market drop and the economic downturn in the past few years, an increasing number of plans are underfunded and require substantial contributions to satisfy the minimum funding standards. In addition, the PBGC is running a record deficit and the pension funding problems of corporate America regularly appears in news articles and magazines.

- **Funding Deficiencies** - Through the third quarter of FY2006, the EP Compliance Unit (EPCU) had sent compliance letters to over 1100 plan sponsors who reported funding deficiencies.
- **Funding Waivers** - In FY2006 the EPCU started to verify the compliance with waivers granted on funding deficiencies. Initial samples of 50 waivers were started. The results will be used to determine the scope of this project..
- **FY 2007 Strategies**

EP will continue to coordinate pension funding concerns with the Department of Labor and the Pension Benefit Guaranty Corporation. We expect the focus will particularly be on large companies in the airlines and automotive industries that have filed for bankruptcy protection. EP will continue to consider making referrals to DOL requesting enforcement action under ERISA section 502(a). As set forth in the Memorandum Of Understanding with PBGC, EP will continue to work with the PBGC with regard to large funding waiver cases.

 - **Funding Deficiencies** - The EPCU contacts all sponsors of Defined Benefit (DB) and Money Purchase (MP) plans who reported a funding deficiency. The Unit pursues correction of the funding deficiency, and ensures that Forms 5330 are filed, and appropriate excise taxes are paid. The EPCU will continue this project during FY2007. Based on data through the second quarter of FY2006, the number of plans reporting a funding deficiency has dropped approximately 15 percent.
 - **Funding Waivers** - Once the results of the FY2006 initial sample are completed and evaluated, the EPCU will make a determination as to how to proceed in ensuring that taxpayers are complying with the terms of the waivers.
- **Take Timely Action to Implement the Provisions of the Pension Protection Act of 2006, Including the Issuance of Technical Guidance and the Processing of Cash Balance Plans that have been Suspended**

- **Background**

Approximately 1,250 determination applications for cash balance conversion plans (hybrid plans that incorporate elements of both defined benefit and defined contribution plans) have been held in suspense for up to 6 years due to pending legislative proposals and various court decisions.

- **FY 2007 Strategies**

The passage of the Pension Protection Act of 2006 on August 17th provides statutory guidance that will allow for the processing of these applications. Timely actions will be taken to expeditiously and consistently process these applications during FY2007. The goal is to complete and issue determination letters on 90% of the cash balance plans that have held in suspense. Rulings & Agreements will work jointly with Chief Counsel and Treasury to issue timely technical guidance.

□ **Analyze and Improve the Focused Examination Concept for All Examinations, and Reinforce the Focus on Key Examination Activities and Issues**

▪ **Background**

In the past, Examinations stressed the importance of a comprehensive approach to examining employee plans. In contrast, the primary objective of the focused examination initiative is to utilize a process that focuses on key issues based on plan type and industry. This allows agents to more effectively and efficiently perform an audit.

Focused techniques are characterized by several key concepts and examination activities:

- Cases are assigned with the expectation that the audit will primarily be focused on three mandatory pre-determined issues.
- The agent takes the following actions:
 - ✓ Performs a comprehensive pre-audit analysis selecting two additional issues;
 - ✓ Solicits only documents required to resolve these issues;
 - ✓ Uses effective interview techniques;
 - ✓ Evaluates a taxpayer's system of internal controls;
 - ✓ Expands the audit scope based on facts and circumstances; and,
 - ✓ Closes the case as soon as the known issues are resolved.

This approach will increase examination coverage and allow agents to work more productively. The agent will determine the compliance level of the taxpayer by conducting an opening interview, reviewing internal controls and examining a few key issues. At that point, the agent will decide to either expand or close the examination.

This approach will also save compliant taxpayers time and money. In addition, agents will spend less time on examinations, which will allow closing letters to be issued earlier. Examinations will focus on issues identified using historical data by plan type, industry type and local knowledge. Using this method, agents can still perform a quality examination, determine if the issues warrant further investigation, and close the case in a timelier manner.

▪ **FY 2007 Strategies**

All examinations will continue to be assigned and worked using focused examination concepts, except those assigned to new hires who have not yet been trained on the concepts. We will begin analyzing results of the FY2006 examination cases worked using focused techniques in an effort to further refine the examination process. We will also use these results to strive to improve both the manner of issue selection and the method of determining the pre-determined issues.

□ **Embed Research and Analysis into Inventory Selection Utilizing Market Segments while Leveraging DAU and EPCU Resources to Ensure Expanded and Broader Coverage through Compliance Contacts**

▪ **Background**

Form 5500 filers were divided into market segments based on the nineteen major business segments that are listed in the instructions for the Form and their plan types. Using prior examination data, ratings were assigned to each market segment for:

- *Risk Assessment* (an estimate of the consequences if we do not perform examinations in a segment). and
- *Risk Reliability* (a measure of how much we know).

The remaining examinations needed to complete the Risk Assessment baseline analysis were assigned during FY2006. Most of those examinations should be completed by the end of FY2007. DAU and Examination resources will be used to help analyze the baseline results which determine the future direction of examination resources. The segments identified with a high degree of non-compliance will be targeted for further examinations.

These Risk Base Targeted (RBT) examinations will improve the use of resources by leading to more productive examinations focusing on less compliant segments. Issues will be pre-selected based upon the analysis of the completed baseline segments. During FY2006, 15 segments with a high degree of non-compliance were identified. Of these, 10 had been started with the remaining 5 to be addressed in FY2007. It is anticipated that the number of risk base targets will increase as the risk assessment baseline results are reviewed.

▪ **FY 2007 Strategies**

The following priorities will be emphasized:

- 1) Leverage DAU and EPCU resources for enhanced inventory selection and to ensure expanded and broader coverage through compliance contacts;
- 2) Complete the summary and analysis of the remaining Risk Assessment Baseline segments;
- 3) Perform Risk Base Targeted (RBT) Examinations on the 15 identified non-compliance segments (see page 9) and any additional closed segments that have a high degree of non-compliance; and,
- 4) Initiate LESE (Learn, Educate, Self-Correct, Enforce) compliance projects: small and quick projects where returns selected for exam contain issues of interest in a particular segment.

The DAU resources provide EP with a unique set of skills that will significantly enhance the ability to analyze the various data sources. They will assist in performing expert level data analysis to determine appropriate examination strategies and ways to improve selection criteria. This includes providing abusive transaction automated support and evaluating trends and patterns in each closed

risk assessment baseline segment. The DAU is currently analyzing the Risk Assessment data using a macro study. The approach seeks to understand plan features, major issues from closed cases, and other common trends by plan type across all business sectors.

As the Risk Assessment Baseline Program is completed and Risk Base Targeted Examination process evolves, the DAU will continue to support Examination in producing studies to aid in compliance targeting. In addition, the DAU will investigate new ways of using available data and analytical techniques while EPCU expands our coverage through compliance contacts.

An analysis of the entire Risk Assessment Program should be completed by the end of FY2007. Examination findings will be shared throughout EP. We will continue refining and updating the risk assessment design and long-term plan. As market segments are closed, the findings will continue to be shared with CE&O for posting on the Retirement Plans web page (www.irs.gov/ep).

In FY2006 there were two industry segments, (Wholesale, Finance and Insurance), which were the primary focus for the Risk Base Target Examinations. The baseline data from the three plan types completed in these industries reflected significant non-compliance. Currently five additional Risk Base Targeted Examination segments have been identified which will be addressed in FY2007. As additional baseline segments are completed and analyzed, additional Risk Base Targeted Examinations will be identified and started in FY2007.

The Areas to be targeted as a result of potentially significant non-compliance trends are:

FY 2007 Risk Base Targeted Segments

| FY 2006 starts | | FY 2007 starts | |
|----------------|---------------------|----------------|------------------------------|
| Plan Type | Industry | Plan Type | Industry |
| Profit Sharing | Wholesale | 401(k) | Prof, Science, Technological |
| Money Purchase | Wholesale | 401(k) | Manufacturing |
| 401(k) | Wholesale | 401(k) | Accom. & Food Services |
| Money Purchase | Retail | Profit Sharing | Accom. & Food Services |
| Money Purchase | Other Services | 401(k) | Health Care & Social Assist. |
| Profit Sharing | Manufacturing | | |
| Money Purchase | Finance & Insurance | | |
| Profit Sharing | Finance & Insurance | | |
| 401(k) | Finance & Insurance | | |
| Profit Sharing | Construction | | |

□ **Continue Efforts to Further Reduce the Inventory Backlog of Voluntary Compliance (VC) Submissions through Improved Work Processes and the Use of Resources throughout Rulings and Agreements**

▪ **Background**

The Employee Plans Compliance Resolution System (EPCRS) provides a comprehensive system of correction programs that permit plan sponsors to correct failures in qualified plans, tax sheltered annuities, etc. Customer demand

has grown for these programs over the years, exceeding past VC processing capabilities. In addition, many submissions have related determination letter applications.

- **FY 2007 Strategies**

The combined resources of R&A will be applied to further reduce the inventory of VC cases and to improve case processing time frames. To accomplish this, VC resources will be supplemented by support from Technical and Determinations. VC will further explore the expanded use of streamlined case processing procedures, including the use of “streamlined compliance statements”.

- **Provide Plain Language Guidance and Communicate Enforcement Trends and Tips to Plan Sponsors and Participants to Enhance Mistake/Abuse Prevention and Promote Retirement Savings via Qualified Plans**

- **Background**

Demand for plain language guidance (“soft guidance”) is increasing each year as plan sponsors/employers and plan participants/employees seek information about the operation of their retirement plans.

Traditionally, published (technical) guidance issued by the Treasury/IRS is written in such detail that it meets the need of the benefits practitioner customer segment. Published guidance includes Treasury Regulations, Revenue Rulings, Revenue Procedures, Notices and Announcements. The following demographics are factors in the increasing demand by the plan sponsor/employer and plan participant/employee customer segments for plain language guidance that meets their unique need for retirement information (allowing them to be able to fully take advantage of the benefits of retirement plans as well as understand and satisfy the responsibilities to be compliant).

- Growth in employee-directed plans (i.e., 401(k) plans) while at the same time the decline in employer-managed plans (i.e., defined benefit plans). The employer-managed plans require the services of benefits practitioners such as enrolled actuaries. Most employee-directed plans (especially IRA-based plan) require less professional assistance.
- Shift of responsibility from employer to employee for many decisions regarding retirement savings. Thus, employees must take on more of the responsibility for their own retirement. Many older workers must make decisions on such things as investment diversification for which they may not be prepared, in order to assure they have enough to live on in later life.

Plain language guidance would involve content posted to Retirement Plans Community web page under the segments for Plan Sponsor/Employer and Plan Participant/Employee. For example, content in the format of frequently asked questions, publications or newsletter articles in the “Employee Plans News”/“Retirement News for Employers” (with imbedded links to more detailed plain language content on the web page) and “Timing Is Everything” educational flyers for plan participants/employees.

- **FY 2007 Strategies**

CE&O will coordinate with Rulings & Agreements and Examinations on providing plain language guidance. Where possible, CE&O will link the plain language guidance to related enforcement trends/tips. The "primary" targeted audience for the plain language guidance is plan sponsors/employers and plan participants and employees. Links can be added to the content to allow users to obtain further technical information - definitions and key words as well as applicable law, regulations and other published guidance. Practitioners can also use the content for their application as well as educating their clients.

A good working model is the Publication 4483, **403(b) Tax-Sheltered Annuity Plan for Sponsor** (Be Aware of Common Mistakes) which reflects mistakes noted from EP examinations plus an online version posted on www.irs.gov/ep with underlined key word(s) that link further to published guidance.

- **Ensure that the New Staggered Determination Process Stays on Schedule, with Special Emphasis on the Review of Defined Contribution Pre-approved Plans**

- **Background**

During the GUST submission process, Master & Prototype plans were submitted to Washington D.C. while Volume Submitter plans were submitted to Cincinnati. Each office was independent in the management of the programs. The plans were reviewed by different personnel and inventory was controlled by separate computer systems.

In order to improve consistency and efficiency, the following were implemented for EGTRRA submissions:

- Both Master & Prototype and Volume Submitter plans were submitted to Cincinnati;
- A dedicated Cadre was established to work Master & Prototype and Volume Submitter plans;
- Uniform training was conducted for the Cadre;
- Consolidated administrative and processing guidance was prepared;
- Uniform computer controls were established for Master & Prototype and Volume Submitter plans;
- New equipment was secured; and,
- A Coordinator position for pre-approved plans was established.

- **FY 2007 Strategies**

The following strategies have been identified:

- Fully utilize a pre-approved plan cadre of fewer than 40 employees to ensure 100% of their direct time is spent working pre-approved plans;
- Continue coordination with the Washington office, Determination groups and Quality Assurance staff to mesh the Pre-approved plans and Determinations programs;

- Maintain an efficient allocation of cases between first and second level reviewers for timely case closure;
- Provide timely and consistent guidance, training and feedback to determination specialists to expedite case processing;
- Complete the HQEP/MAPICS conversion to Cincinnati, so that the system is generating regular reports and is ready to issue final approval letters; and.
- Begin issuing “e-mail” approvals on Defined Contribution specimen plans to prepare cases for closure.